

South Carolina Department of Insurance

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BULLETIN NUMBER 2009-06

TO: All Insurers Transacting Business in South Carolina

FROM: Scott H. Richardson, CPCU 
Director

SUBJECT: Implementation of Annual Audited Financial Reporting Regulation

DATE: June 2, 2009

I. PURPOSE AND SCOPE OF THIS BULLETIN

On May 22, 2009, S.C. Code Ann. Regulation 69-70, the Annual Audited Financial Reporting Regulation (Regulation), became final upon publication in the *State Register*. A copy of the Regulation is attached and labeled as Exhibit 1. The South Carolina Department of Insurance (Department) is charged with the responsibility of enforcing the provisions set forth in the Regulation.

The purpose of this Bulletin is 1) to provide a brief overview of the Regulation; 2) to outline the procedures for requesting an exemption from any provision or requirement of this Regulation; 3) and to outline the effective dates for certain of the requirements set forth in the Regulation.

This bulletin applies to any health maintenance organization, title insurer, fraternal organization, burial association, other association, corporation, partnership, society, order, individual, or aggregation of individuals engaging or proposing or attempting to engage as principals in any kind of insurance or surety business, including the exchanging of reciprocal or interinsurance contracts between individuals, partnerships, and corporations.

The Department will issue a separate bulletin to specify the application of this Regulation to captive insurers and special purpose financial captive insurers.

The Regulation is generally effective for reporting periods ending December 31, 2010. An *Implementation Guide* has been published by the National Association of Insurance Commissioners to assist insurers in planning and preparing for compliance with the new requirements when they become effective. A copy of the *Implementation Guide* is attached and labeled as Exhibit 4. The *Implementation Guide* may also be found on the home page of the National Association of Insurance Commissioners' website, www.naic.org.

II. OVERVIEW OF THE ANNUAL AUDITED FINANCIAL REPORTING REGULATION

The Regulation has been promulgated to improve the Department's surveillance of the financial condition of insurers by requiring (1) an annual audit of financial statements reporting the financial position and the results of operations of insurers by independent certified public accountants, (2) Communication of Internal Control Related Matters Noted in an Audit, and (3) Management's Report of Internal Control over Financial Reporting.

A. What insurers are subject to the Regulation?

Every insurer as defined in Section 3A(7) of the Regulation:

“‘Insurer’ includes any captive insurer, special purpose financial captives insurer, health maintenance organization, title insurer, fraternal organization, burial association, other association, corporation, partnership, society, order, individual, or aggregation of individuals engaging or proposing or attempting to engage as principals in any kind of insurance or surety business, including the exchanging of reciprocal or interinsurance contracts between individuals, partnerships, and corporations.”

As previously indicated, the Department will issue a separate bulletin to specify the application of this Regulation to captive insurers and special purpose financial captive insurers. The Regulation also sets forth the insurers who are exempt from the application of the Regulation.

B. Exemptions.

The following exemptions apply:

1. An insurer having direct premiums written in South Carolina of less than \$1,000,000 in any calendar year and less than 1,000 policyholders or certificateholders of direct written policies nationwide at the end of the calendar year shall be exempt from the Regulation for the year (unless the Director makes a specific finding that compliance is necessary for the Director to carry out statutory responsibilities) except that insurers having assumed premiums pursuant to contracts and/or treaties of reinsurance of \$1,000,000 or more will not be so exempt.

In order to claim the exemption, the insurer must complete and submit the attached “Annual Audited Financial Reports - Premium and Policyholders or Certificateholders Exemption Affidavit,” labeled as Exhibit 2, by March 1 of the year for which the exemption is being claimed.

2. Foreign or alien insurers filing the Audited Financial Report in another state, pursuant to that state's requirement for filing of Audited Financial Reports, which has been found by the Director to be substantially similar to the requirements of the Regulation, shall be exempt from Sections 4 through 13 of this regulation if:
 - (a) A copy of the Audited Financial Report, Communication of Internal Control Related Matters Noted in an Audit, and the Accountant's Letter of Qualifications that are filed with the other state are filed with the Director in accordance with the filing dates specified in Sections 4, 11 and 12, respectively (Canadian insurers may submit accountants' reports as filed with the Office of the Superintendent of Financial Institutions, Canada).

(b) A copy of any Notification of Adverse Financial Condition Report filed with the other state is filed with the Director within the time specified in Section 10.

3. Foreign or alien insurers required to file Management's Report of Internal Control over Financial Reporting in another state are exempt from filing the Report in this state provided the other state has substantially similar reporting requirements and the Report is filed with the commissioner of the other state within the time specified.

C. Hardship Waiver(s).

The Director may grant an exemption from compliance with any provision or requirement of the Regulation if the Director finds, upon review of a written application of the insurer, that compliance with the Regulation would constitute a financial or organizational hardship upon the insurer.

In order to apply for an exemption, the insurer must complete and submit the attached "Annual Audited Financial Reports Financial or Organizational Hardship Exemption Affidavit," labeled as Exhibit 3, by March 1 of the year for which the exemption is being requested.

An exemption may be granted at any time and from time to time for a specified period or periods. Within ten days from a denial of the insurer's written request for an exemption from the Regulation, the insurer may request in writing a hearing, pursuant to statute, on its application for an exemption. The hearing shall be held in accordance with the statutes of the Department pertaining to administrative hearing procedures.

D. Effective Dates.

1. Unless otherwise noted, the requirements of this Regulation shall become effective for the reporting period ending December 31, 2010, and each year thereafter.
 - a. An insurer or group of insurers not required to file a report because its total written premium is below the threshold that subsequently becomes subject to the reporting requirements shall have two years following the year the threshold is exceeded (but not earlier than December 31, 2010) to file the report.

For example, if an insurer's total premium exceeded the threshold in 2010, the insurer will be required to file a report for the period ending December 31, 2012.

- b. An insurer acquired in a business combination shall have two calendar years following the date of acquisition or combination to comply with the reporting requirements.

For example, an insurer acquired in a business combination in 2010 will be required to file a report for the period ending December 31, 2012.

2. The requirements of Section 7D of the Regulation shall become effective for audits of the year beginning January 1, 2010 and thereafter. Reference to "Lead Audit Partner Rotation Requirement" in the *Implementation Guide* is encouraged.

3. The requirements of Section 14 of the Regulation shall become effective on January 1, 2010.
- a. An insurer or group of insurers that is not required to have independent Audit Committee members or only a majority of independent Audit Committee members (as opposed to a supermajority) because the total direct written and assumed premium is below the threshold and subsequently becomes subject to one of the independence requirements due to changes in premium shall have one year following the year the threshold is exceeded (but not earlier than January 1, 2010) to comply with the independence requirements.

For example, an insurer that reaches the \$300 million requisite threshold in its December 31, 2011 audited statutory statement and therefore will be required to meet the “majority (50% or more) member independence” Audit committee requirements by January 1, 2013.

- b. An insurer that becomes subject to one of the independence requirements as a result of a business combination shall have one calendar year following the date of acquisition or combination to comply with the independence requirements.

For example, an insurer that becomes subject to one of the independence requirements as a result of a business combination in 2011 will be required to file a report for the period beginning January 1, 2013.

III. QUESTIONS

Questions regarding this Bulletin should be submitted in writing to:

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IV. APPENDIX

The following exhibits are attached:

- Exhibit 1:** R 69-70, Annual Audited Financial Reporting Regulation
Exhibit 2: Annual Audited Financial Reports - Premium and Policyholders or Certificateholders Exemption Affidavit
Exhibit 3: Annual Audited Financial Reports – Financial or Organizational Hardship Exemption Affidavit
Exhibit 4: *Implementation Guide for the Annual Financial Reporting Model Regulation*, NAIC

Bulletins are the method by which the Director of Insurance formally communicates with persons and entities regulated by the Department. Bulletins are departmental interpretations of South Carolina insurance laws and regulations and provide guidance on the Department’s enforcement approach. Bulletins do not provide legal advice. Readers should consult applicable statutes and regulations or contact an attorney for legal advice or for additional information on the impact of that legislation on their specific situation.